

Revenue Review

Tennessee Department of Revenue

July 2004

REVENUE ...
Working for You!

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Did You Know...

You can receive notices and other publications instantly by signing up on the department's ListServ?

Visit our Web site to subscribe to Revenue-News or lists dedicated to county clerks and city officials.

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Nashville, TN 37242
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(800) 342-1003

2004 Legislative Changes

The Department of Revenue tracked 160 pieces of legislation during the 2004 session which officially ended on May 21, 2004. A number of tax law changes were made during this session. A complete Legislative Summary listing is available on the department's Web site at www.Tennessee.gov/revenue. A complete copy of the public chapter may be found on the Tennessee Secretary of State's Web site at www.state.tn.us/sos. Summaries of broader interest are included below.

Franchise Tax and Excise Tax Legislation

Low-income Housing Exemption for Limited Liability Entities: LPs and LLCs organized exclusively for the purpose of providing affordable housing are exempt from franchise, excise tax if the entity receives an allocation of low-income housing tax credits pursuant to Section 42 of the Internal Revenue Code (IRC) of 1986 and has in effect an "extended low-income housing commitment" as defined in IRC Section 42(h)(6)(B) with respect to each residential building owned by the entity for the period covered by the return. *Public Chapter 924. Effective date: Tax periods ending on or after 6/30/03.*

New Disclosure Requirements for Intangible Expense Deductions: See inset p. 2.

New 50% Penalty Provisions on Failure to Disclose Transactions: A 50% penalty will apply when any person negligently fails to disclose a transaction as required by statute and fails to pay the total amount of taxes due. The penalty applies to the amount of the underpayment. *Public Chapter 786. Effective date: 5/28/04.*

Requirement for Capital Gain Realization on Distribution of Assets: A capital gain on the sale of an asset must be recognized if the asset is sold within 12 months of being distributed to a nontaxable entity. If the distributing entity liquidates prior to the asset sale, the otherwise nontaxable individual is liable for the excise tax on the gain. If the entity merges into a nontaxable entity which then sells the asset, the nontaxable entity is liable for the excise tax on the gain. If the entity executes a document forfeiting its limited liability protection within the 12-month period immediately prior to sale, the entity itself remains liable for the excise tax on the gain. The new 50% penalty for failure to disclose a transaction may be applied for failure to report this gain by the appropriate entity. *Public Chapter 592. Effective date: Applies to asset sales occurring on or after 7/1/04.*

Finished Goods Inventory Definition Clarified

The definition of finished goods inventory for franchise tax purposes has been clarified. In 1995, a provision was enacted to encourage the development of manufacturing, warehousing and distribution facilities in the state by setting a cap on the value of finished goods inventory included in the taxpayer's franchise tax base minimum measure. The new law clarifies the incentive by providing that such inventory must be held at a manufacturing, warehousing or distribution facility rather than a facility where retail sales are made to customers. *Public Chapter 924. Effective date: Tax periods beginning on or after 1/1/04.*

Jobs Tax Credit Enhancement, New Sales and Use Tax Exemptions for Qualified Headquarter Facilities

The Department of Economic and Community Development (ECD) and the Department of Revenue worked together to make improvements to our laws designed to enhance job recruitment in Tennessee.

Expanded Jobs Tax Credits: For businesses located in economically distressed counties, jobs tax credit is expanded from \$3,000 to \$4,500, and the 25-job threshold is removed so that businesses can take the credit starting with the first new job created. Additional information on this law is available on our Web site. *Public Chapter 592. Effective date: 5/3/04.*

Use Tax Exemption for Aircraft Moved to Tennessee by Qualified Headquarters Facility: Companies that establish a new headquarters facility in Tennessee may move their otherwise taxable aircraft into the state without incurring use tax liability on the aircraft. *Public Chapter 924. Effective date: 6/7/04. (Expires 7/1/08.)*

Sales Tax Exemption for Private Communication Services Sold to Qualified Headquarters Facility: As part of the revision to the sales tax levied on telecommunication services (see p. 3), an exemption is available for "private communication services" used for communication with a computer or telecommunications center located in this state by a taxpayer that has qualified for the headquarters tax credit or by an affiliate of such taxpayer. To make these purchases without the payment of sales tax, a taxpayer is required to provide sellers a copy of a certificate issued by the department. Taxpayers who have qualified for the headquarters credit should contact the department concerning this exemption. *Public Chapter 782. Effective date: 7/1/04.*

2004 Legislative Updates, *continued* Franchise Tax and Excise Tax Legislation

Permanent Decoupling from Federal Accelerated Depreciation

Enacted: Tennessee clarified legislation enacted in 2002 to permanently decouple from federal accelerated depreciation for excise tax purposes. Depreciation should be calculated using the schedules that existed immediately prior to the federal Job Creation and Worker Assistance Act of 2002. If any taxpayer for tax years ending on or after 7/15/02 failed to accurately calculate the proper amount of depreciation as a result of ambiguity in the prior law and such failure led to the underpayment of tax, then the taxpayer has until 6/30/04 to make additional payments without penalty or interest. *Public Chapter 785. Effective date: Tax periods ending on or after 7/15/02.*

The increase in the IRC Section 179 expense election from \$25,000 to \$100,000 will be allowed for excise tax purposes and is not affected by this legislation.

Returns that are required to be amended as a result of this clarification must be filed by 6/30/04. Interest and penalty for additional liability as a result of this clarification will not begin until after 6/30/04. General waiver of penalty provisions will apply. Taxpayers also have until 6/30/04 to make additional payments needed to meet the 90% requirement for fiscal year 2003 returns that have been extended and not yet filed. Estimated payments for 2004 should be adjusted for payments due after 7/1/04. No penalty and interest will accrue as a result of this clarification for estimated payments due prior to 7/1/04.

"Stock-Held" Deduction from Franchise Tax Repealed, Replaced with Voluntary Net Worth Consolidated Filing:

The deduction from a taxpayer's net worth base for the value of stock held in companies doing business in Tennessee has been repealed and replaced with a voluntary election to calculate the net worth base for franchise tax purposes on a consolidated basis. Once made, the election is binding for a minimum of 5 years. Taxpayers continue to pay on the greater of apportioned net worth or the value of real and tangible personal property in Tennessee regardless of the method that is used to arrive at their apportioned net worth. *Public Chapter 932. Effective date: Tax periods beginning on or after 1/1/04.*

New Deduction for Qualified Charitable Donations: Legislation was passed enacting a new deduction from net earnings for excise tax purposes equal to 75% of the amount donated to a qualified public school support group. The school support group must be registered with the Department of Revenue for sales and use tax purposes, must spend the donated funds on goods or services subject to sales and use tax, and must certify to the taxpayer making the donation that the sales and use tax has actually been paid. *Public Chapter 835. Effective date: Tax periods on or after 7/1/04.*

The department is preparing guidelines for administration of this new deduction. These guidelines should be available on the department's Web site by early August 2004.

2004 Legislative Updates, *continued* Franchise Tax and Excise Tax Legislation

Disclosure Requirements Set for Intangible Expense Deductions on Excise Tax Return:

For tax periods beginning on or after 1/1/04, taxpayers are required to disclose on their excise tax return any intangible expenses paid to an affiliated company. If properly disclosed, the taxpayer will be allowed to take the expense as a deduction from taxable income. The department will use this information to examine such transactions on a case-by-case basis. If the taxpayer fails to make the disclosure and underpays its excise tax liability, a 50% negligence penalty will be imposed on the amount of any underpayment (see Public Chapter 786). Intangible expenses are expenses related to intangible property, such as patents, trademarks, franchise rights, etc. An affiliated company is one in which the taxpayer has more than 50% ownership interest, one that has more than 50% ownership interest in the taxpayer, or one in which the taxpayer's parent company has more than 50% ownership interest. *Public Chapter 924. Effective date: Tax periods beginning on or after 1/1/04.*

located in our Important Notices section.

Exemption for Qualified Diversified Investing Funds:

Diversified investing funds are exempt from franchise, excise tax if the fund is an LP, LLP, or LLC that is formed and operated for the purpose of buying, holding or selling qualified investment securities on its own behalf. The capital of the fund must be primarily derived from investments by entities or individuals that are not affiliated with the fund. At least 90% of the fund's income must consist of interest, dividends and gains from the sale or exchange of such investment securities. *Public Chapter 580. Effective date: 5/3/04.*

Entities taking this exemption must file an annual form in lieu of a tax return affirming that it met the exemption requirements for the period that would be covered by the return were it not for the exemption.

Farming Activities: The definition of "farming" for franchise and excise tax purposes has been amended to include the leasing of land that is used for farming. Also, a family-owned, non-corporate entity is allowed to maintain its exemption from tax if it derives substantially all of its income from a combination of farming activities and passive investments. *Public Chapter 592. Effective date: 5/3/04.*

Railroad Companies:

For purposes of calculating the value of real and tangible personal property for Schedule G, railroad companies may value such property in accordance with the method used for federal tax purposes so long as the method used for federal tax purposes fairly reflects the property's actual value. *Public Chapter 924. Effective date: 6/7/04.*

Sales and Use Tax Legislation

Streamlined Sales and Use Tax Update:

The Streamlined technical corrections legislation passed this session added an effective date of **July 1, 2005**, for all provisions of Tennessee's Streamlined legislation, with one exception. The provisions relating to the repeal of the local tax cap on single articles (other than cars, boats, planes and mobile homes) will not take effect until January 1, 2006. Additional information on the Streamlined Sales and Use Tax Agreement and on Tennessee's legislation is available on our Web site. Also, additional information on this topic will be contained in an upcoming newsletter. *Public Chapter 959.*

Sales and Use Tax Compliance Agreements (SUTCAs): The department now has discretion to enter into sales and use tax compliance agreements with taxpayers that have good audit and filing histories with the state. SUTCAs are up-front agreements that detail the manner in which the taxpayer is to calculate and report tax on its purchases and the manner in which the tax compliance is to be evaluated on audit. *Public Chapter 786. Effective date: 5/28/04.*

Other New Sales Tax Exemptions:

An exemption for qualified vehicles used principally to carry cargo or passengers in interstate commerce is available to common and contract carriers regardless of whether they sell their services for a fee, provided that all requirements of TCA § 67-6-331 are met. *Public Chapter 924. Effective date: 6/7/04.*

Licensed motor vehicle dealers and licensed automobile auctions may now purchase motor vehicle detailing and repair services on a resale certificate if the vehicle is held for resale. "Detailing services" are defined in the new law and repair services are defined in Sales Tax Rule 54. *Public Chapter 924. Effective date: 6/7/04.*

The sale of helicopters within Tennessee to purchasers who are not Tennessee residents are exempt when such helicopters remain in Tennessee after the sale solely for purposes of repair or refurbishment and are removed from Tennessee within 15 days of the completion of such repair or refurbishment. Repair and refurbishment includes modifications, conversions, and installations. This exemption works in conjunction with existing exemptions for the sale and repair of helicopters that are removed from the state within 15 days. *Public Chapter 724, amending TCA § 67-6-313(h). Effective date: 05/19/04.*

An exemption from contractor's use tax is available for any tangible personal property that is owned by the United States and provided to a contractor on a temporary basis to be tested provided that the exemption only applies to contracts awarded by the United States under the Small Business Innovation Research Program, and does not apply to equipment or other property used to conduct the test. *Public Chapter 725. Effective date: 5/19/04.*

An exemption is provided for insurance proceeds paid to the owner of a leased vehicle pursuant to a damage settlement. The exemption applies when the vehicle has sustained damage that renders it a salvage vehicle, nonrepairable vehicle or flood vehicle and the owner transfers title to the leased vehicle to the insurance company. *Public Chapter 823. Effective date: 6/7/04.*

2004 Legislative Updates, *continued*

Tennessee Enacts Telecommunications Sales Tax Changes:

Tennessee has levied sales taxes on "telecommunications services" since 1989. In view of changing technologies, the department worked with members of the telecommunications industry to modernize the laws that applied to this sales tax. "Telecommunications services" is now defined as:

"the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points. The term 'telecommunications services' includes such transmission services in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such services are referred to as enhanced or value added services."

This definition clarifies the taxability of transmissions such as Voice Over Internet Protocol, and clarifies that services such as Internet access and information services are not telecommunications services.

The law provides a "primary purpose" to determine when something is an information service rather than a telecommunication service. Tennessee does not tax information services. There are many services that contain elements of both types of services. Examples of services that would not be taxable under this section include check guaranty or credit card guaranty services, database search services, and home security system services. Each of these services use telecommunications to provide the service, but the primary purpose of the service is the information. Thus, the seller of the information service pays tax on the purchase of telecommunications services used to provide the information service.

"Ancillary services," including voicemail, call forwarding, and call waiting, are separately taxable services. These charges were previously taxable as part of the "gross charges" for telecommunications services.

The exemption for and definition of "private line service" is repealed.

A new definition of "private communication services" is added, and an exemption is provided for taxpayers who have established qualified headquarters facilities in the state. See inset p. 1.

Please visit our Web site for more information on this law change located in our Important Notices section.

Pollution Control Credit

The sales and use tax pollution control credit contained in TCA § 67-6-346 has been amended to clarify that it applies to purchases of equipment and other items primarily used to treat pollution created by the taxpayer. The credit does not apply to taxpayers that primarily treat pollution created by others. *Public Chapter 924. Effective date: 6/7/04.*

Aircraft Repair Services

Companies engaged in the repair of aircraft for unrelated commercial or governmental entities may qualify for sales and use tax manufacturing exemptions. *Public Chapter 924. Effective date: 6/7/04.*

2004 Legislative Updates, *continued* ***Sales and Use Tax Legislation***

Exemption Passed for Motor Vehicle Sales to Members of Armed Forces

An exemption from sales tax is permitted for sales of motor vehicles to members of the Tennessee National Guard or reserve members of a uniformed service of the United States who are called into active military service and who are stationed outside the United States during hostilities in which such person is actually engaged in combat. The motor vehicle may be purchased with a general power of attorney on behalf of the armed forces member, and a copy of the military orders must be provided to the automobile dealer. *Public Chapter 842. Effective date: 6/8/04.*

Other Legislative Updates

Business Tax Changes for the Sale of Services to an Affiliate

The definition of "services" for business tax purposes has been amended to specify that taxable services for profit or monetary gain do not include those services rendered by a person for an affiliated business entity if the services are accounted for as allocations of cost incurred in providing the service without any markup whatsoever. *Public Chapter 592. Effective date: 5/3/04.*

The definition of "sales price" for business tax purposes has been amended to specify that tax does not apply to the amount that is accounted for as a reasonable allocation of cost incurred in rendering services to an affiliated company. Tax does apply to the amount of markup on such services. An affiliated company is one in which the taxpayer has more than 50% ownership interest, one that has more than 50% ownership interest in the taxpayer, or one in which the taxpayer's parent company has more than 50% ownership interest. *Public Chapter 924. Effective date: Tax periods for which returns were required to be filed on or after 1/1/01.*

Law Changes Enacted Related to Preservation of Historic Properties

New exemptions were enacted for a corporation or LLC that: 1) is directly or indirectly owned and controlled by a not-for-profit entity; 2) is organized for the purpose of preserving or rehabilitating a historic property listed on the National Register of Historic Places; and 3) the controlling not-for-profit entity has received approval of its historic certification application from the U.S. Department of the Interior National Park Service. Qualifying taxpayer entities are exempt from franchise, excise tax. Furthermore, a sales or use tax exemption exists for tangible personal property or taxable services sold, given, or donated to an entity that meets all of the above-stated requirements provided that the requirements of TCA § 67-6-322(d), (e) and (f) are met. *Public Chapter 812. Effective date: The franchise, excise tax exemption applies to tax periods ending on or after 9/1/03. The sales and use tax exemption takes effect on 6/3/04.*

College Education Savings Plans and Individual Income Tax

Public Chapter 712 exempts from individual income tax the income and distributions of college educational savings plans. Effective for all plans in effect on or after 5/18/04.

Don't Forget! Deadlines for Filing Refunds for Sales Taxes Collected on Internet Access Charges

The department issued a notice on May 19, 2004, regarding procedures to claim refunds on sales tax collected on Internet access charges. Consumers must claim the refund from their ISP by July 17, 2004, and the ISP must file the claim for refund with the department by September 15, 2004. More details may be found at <http://www.tennessee.gov/revenue/notices/sales/sales04-09.pdf>.

Extension to File Professional Privilege Tax Return and Individual Income Tax for Military Personnel

Military personnel stationed outside the United States in a theater of operations during hostilities can file their returns up to 180 days following the end of hostilities or 180 days after they are transferred from the theater of operations, whichever is sooner. *Public Chapter 800. Effective date: 6/3/04.*

Did You Know...

Tax collections and statistics are a click away on Revenue's Web site? Go to www.Tennessee.gov/revenue and click on "Tax Collections and Statistics" to access the figures.

Online Business Tax Registration

In April, the Department of Revenue launched a new online option for many business tax registration activities. Since its launch, more than 2,000 business tax registration transactions have been made online.

You can do the following online:

- Register a business
- Add a new location to an existing business in Tennessee
- Change the business address(es)
- Close a business account
- Note a change in ownership

These online registration activities can be done for the following taxes:

- Franchise and Excise Taxes
- Sales and Use Tax
- Television and Telecommunications Tax
- Motor Vehicle Surcharge
- Tire Fee
- Used Motor Oil

Speakers Bureau

The Department of Revenue offers a speakers bureau. Professionals from across the state are available at no charge for professional groups, civic clubs, special events and academic organizations in Tennessee. Speakers are available to present on a variety of topics, from Streamlined Sales Tax and franchise and excise taxes to inheritance and gift taxes.

Call (615) 741-2461, e-mail emily.richard@state.tn.us, or write to Emily Richard, Tennessee Department of Revenue, 500 Deaderick Street, Suite 1200, Nashville, TN 37242, to request a speaker. Requesting agencies/organizations should contact the department at least two weeks in advance and provide the following information.

- Date and time speaker needed
- Name of group requesting speaker
- Location
- Topic
- Desired length of presentation
- Number of people expected to attend presentation
- Contact name, address, phone number and e-mail address

E-filing Options

Currently, electronic filing of the individual income tax, professional privilege tax, sales and use tax, consumer use tax, and franchise and excise tax minimum payment returns is available via the Department of Revenue's Web site, www.Tennessee.gov/revenue. Many business tax registration activities also can be done online. Information about motor fuel tax electronic data interchange and sales and use tax certified software providers is available on Revenue's Web site. Electronic funds transfer is also available on the Web site.

The department offers computer access in its Nashville, Chattanooga, Knoxville, Johnson City, Memphis and Jackson offices for taxpayers to e-file taxes.

Contact Us

- Taxpayer hot line: Statewide toll-free (800) 342-1003; Nashville-area and out-of-state callers should call (615) 253-0600.
- Online tax help by e-mailing TN.Revenue@state.tn.us.
- Streamlined Sales Tax hot line: In Tennessee, call (877) 250-2299. In Nashville and outside Tennessee, call (615) 253-0752.
- Streamlined Sales Tax online assistance by e-mailing Streamlined.Salestax.QandA@state.tn.us.
- Tax practitioner hot line: Statewide toll-free (800) 397-8395; Nashville-area and out-of-state callers should call (615) 253-0700.
- E-mail updates: We distribute timely information about new important notices, announcements and other news of interest. Visit our Web site, www.Tennessee.gov/revenue, to subscribe to Revenue-News or lists dedicated to county clerks and city officials.
- Tax fraud hot line: To report tax fraud, call (800) FRAUDTX (372-8389).

Main Office to Serve You

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2486 Park Plus Drive
Suite A
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(931) 380-2523

Cookeville
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Jackson
Lowell Thomas State Office
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225 Dr. Martin Luther King Jr.
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Johnson City, TN 37601
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P.O. Box 144
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321 Bethany Lane
Shelbyville, TN 37160
(931) 685-5010

We Want Your Feedback

We work each day to serve our customers. Your feedback on our customer service and our Web site helps us provide outstanding service and meaningful, useful information on the Internet. To let us know how we're doing and how we can better meet your needs, visit our Web site, www.Tennessee.gov/revenue, and click on "We want to hear from you!" Separate surveys related to our service and our Web site are available for online completion.

Report Tax Cheats!

The Department of Revenue is committed to ensuring a level playing field for all taxpayers and needs your help to do this. The Department of Revenue promotes voluntary taxpayer compliance by educating taxpayers, aggressively pursuing criminal sanctions and demanding accountability when taxpayers engage in fraudulent activity.

Fraud is a deception deliberately practiced in order to secure unfair or unlawful gain. As it relates to taxes, it's simply "cheating" by intentionally paying less tax than is legally due.

If you suspect someone or some company is committing fraud, report this information directly to the Department of Revenue's Special Investigations Section. You can report fraud anonymously. It may be helpful for the agent to contact the person reporting the fraud for more details; however, this information is not required. Due to taxpayer confidentiality laws, the department cannot keep you informed of the progress of the investigation.

Call toll-free (800) FRAUDTX or (800) 372-8389.

Penalties Associated with Tax Fraud Activities

Tax fraud is a serious violation of Tennessee law and can result in stiff penalties for violators.

Motor Fuel Tax Violations

If someone is caught using dyed diesel fuel in a licensed diesel vehicle, that individual or company may be subject to the greater of \$1,000 civil assessment or \$10 per gallon of dyed diesel fuel involved for the first violation and, depending on the circumstances, could face potential criminal action as well.

Possible Criminal and Civil Sanctions

If fraud is found, violators will have to pay restitution in the amount of tax owed and pay a possible 100% fraud penalty. Convicted violators may be arrested and could face a jail sentence. Once the criminal case is concluded, civil taxes, penalties and interest will be due the state.

Save the Date: Upcoming Seminars and New Business Workshops Across the State

Visit our Web site, www.Tennessee.gov/revenue, and click on "Seminars, New Business Workshops and Speakers" to learn more about these and other upcoming seminars and workshops.

July

July 14 – New Business Workshop, Chattanooga

July 14 – New Business Workshop, Knoxville

July 15 – New Business Workshop, Johnson City

July 15 – New Business Workshop, Memphis

July 20 – Tennessee Business Taxes, Austin Peay State University, Clarksville

July 22 – Tennessee Business Tax, University of Tennessee at Chattanooga, Chattanooga

July 27 – New Business Workshop, Nashville

July 28 – Tennessee Business Taxes, The Centre at Millennium Park (East Tennessee State University), Johnson City

September

Sept. 15 – New Business Workshop, Chattanooga

Sept. 15 – New Business Workshop, Knoxville

Sept. 16 – New Business Workshop, Johnson City

Sept. 16 – New Business Workshop, Memphis

Sept. 28 – New Business Workshop, Nashville

Online Sales Tax Filing Statistics (since its launch in July 2003)

Month	Number of Returns	Total Amount Collected
July 2003	202	\$2,061,357
August 2003	430	\$4,663,761
September 2003	673	\$7,406,442
October 2003	1,169	\$11,593,221
November 2003	1,429	\$18,020,316
December 2003	1,917	\$22,175,036
January 2004	2,997	\$36,795,892
February 2004	6,775	\$70,279,623
March 2004	7,752	\$72,212,739
April 2004	8,645	\$91,593,839
May 2004	9,057	\$96,826,356



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